

Message Text

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ACTION EUR-08

INFO OCT-01 SS-14 ISO-00 CIAE-00 EA-06 EB-04 INR-05
IO-06 NSAE-00 ICAE-00 SSO-00 INRE-00 NEA-07 SIL-01
SP-02 PA-01 NSCE-00 /055 W
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O 131622Z JUL 78
FM AMEMBASSY ROME
TO SECSTATE WASHDC IMMEDIATE 4193
TREASURY DEPT WASHDC IMMEDIATE
INFO AMEMBASSY BUSSELS
AMEMBASSY BONN
AMEMBASSY LONDON
AMEMBASSY PARIS
AMEMBASSY TOKYO

C O N F I D E N T I A L SECTION 1 OF 2 ROME 12950

LIMDIS

USEEC; PARIS ALSO FOR USOECD

E.O. 11652: GDS
TAGS: EFIN, IT
SUBJECT: ITALY'S ECONOMIC PROGRAM AND IMF NEGOTIATIONS

NOTE: THIS IS THE SECOND OF TWO MESSAGES ON
AMBASSADOR'S MEETING WITH TREASMIN PANDOLFI.

1. SUMMARY. PANDOLFI INDICATED THAT HE HAS JUST
ABOUT COMPLETED HIS THREE-YEAR PLAN TO REDUCE THE
PUBLIC SECTOR DEFICIT, WHICH IS EXPECTED TO BRING
INFLATION DOWN BELOW DOUBLE DIGIT BY 1980. HE
HAS DISCUSSED HIS STRATEGY WITH THE IMF (WHITTOME),
AND A DRAFT LETTER OF INTENT INCORPORATING THE
DETAILS IS BEING PREPARED FOR SIGNATURE IN
OCTOBER. THE NEW STAND-BY WILL BE FOR 1.0 BILLION
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SDRS. IN ORDER TO HELP WELL HIS PROGRAM TO POL-
ITICAL PARTIES AND LABOR UNIONS, THE MINISTER HOPES
TO SHOW PROGRESS ON INVESTMENTS (PARTICULARLY
FOREING INVESTMENTS) IN THE MEZZOGIORNO, IN THE
AREAS OF AGRICULTURE, TOURISM AND HOUSING. FOR
MAXIMUM EFFECT, HE IS THINKING OF MAKING A DRAMATIC
MOVE, SUCH AS OBTAINING A LARGE FOREIGN LOAN FOR

INVESTMENTS IN THE SOUTH. HE WOULD LIKE TO COUPLE THE SIGNING OF SUCH A LOAN WITH A VISIT TO THE US. HE CLAIMED THERE IS NO SHORTAGE OF LOAN OFFERS FROM AMERICAN AND OTHER FOREIGN BANKS; THE PROBLEM, HE SAID, IS THE INABILITY OF THE GOVERNMENT MACHINERY TO SPEND MONEY. END SUMMARY.

2. PANDOLFI SAID THAT HIS THREE-YEAR ECONOMIC PROGRAM ENVISAGES A GRADUAL REDUCTION IN THE PUBLIC SECTOR DEFICIT AS A PROPORTION OF GDP. THE LATEST ESTIMATES PLACE THE ENLARGED PUBLIC SECTOR DEFICIT IN 1978 AT 33,000 BILLION LIRE (OF WHICH 28,000 IS NEW DEBT AND 5,000 REPRESENTS CONSOLIDATION OF PREVIOUS DEBTS OF LOCAL AUTHORITIES), OR 16.5 PERCENT OF GDP. IN 1979, HE PLANS TO REDUCE THE RATIO OF DEBT/GDP TO 15.5 PERCENT. TO MAKE THIS POSSIBLE, THE ANTICIPATED DEFICIT HAS TO BE REDUCED FROM 44,000 BILLION LIRE TO 37,000 BILLION LIRE. HE EXPECTS TO ACHIEVE THE 9,000 BILLION LIRE REDUCTION BY A 2,000 BILLION LIRE INCREASE IN REVENUE AND A 5,000 BILLION LIRE CUT IN EXPENDITURES. REVENUES WOULD BE RAISED BY A SURTAX ON PERSONAL INCOME AND PERHAPS BY A BOOST IN THE GASOLINE TAX. TO REDUCE EXPENDITURES BY 5,000 BILLION LIRE, PANDOLFI IS PROPOSING AMORATORIUM ON ALL AUTOMATIC (MAINLY INDEXED) INCREASES IN EXPENDITURES
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FOR PENSIONS, HEALTH, AND LOCAL AUTHORITIES. IN THE AREA OF PENSIONS, RECEIPIENTS WOULD BE GRANTED A FLAT INCREASE NEXT YEAR AND NOT ONE RELATED TO INFLATION THROUGH THE SYSTEM OF INDEXATION. THIS MEASURE ALONE WOULD SAVE 3,000 BILLION LIRE. THE MINISTER IS SCHEDULED TO LAY OUT HIS PROGRAM TO THE COUNCIL OF MINISTERS ON FRIDAY AND EXPECTS TO PUBLISH IT NEXT WEEK. WITH THE IMPLEMENTATION OF THE GOVERNMENT'S PROGRAM, INFLATION IS PROJECTED TO DROP FROM 14 PERCENT IN 1978, TO 12 PERCENT IN 1979, AND TO 9 PERCENT IN 1980.

3. TURING TO LABOR COSTS, THE MINISTER NOTED THAT THE GOVERNMENT'S OBJECTIVE IS TO KEEP REAL WAGES CONSTANT IN 1979. HE HOPES TO ACHIEVE THIS BY PERSUADING THE UNIONS TO MODERATE THEIR DEMANDS THIS FALL AND ACCEPT A FLAT ANNUAL SETTLEMENT OF 10,000 LIRE OR LESS PER MONTH IN EXCHANGE FOR A PROMISE TO KEEP THE SCALA MOBILE IN PLACE. PANDOLFI

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CLAIMED THAT THIS KIND OF SETTLEMENT WOULD
ASSURE CONSTANT REAL WAGES, SINCE THE SCALA MOBILE
COVERS ON THE AVERAGE 90 PERCENT OF INFLATION.
IN ORDER TO GET THE UNIONS TO AGREE TO THIS
STRATEGY, HOWEVER, THE GOVERNMENT WILL HAVE TO
PROMISE NEW INVESTMENTS IN THE MEZZOGIORNO AND NEW
EMPLOYMENT OPPORTUNITIES. IN THIS CONNECTION, THE
MINISTER HOPES TO TAKE ADVANTAGE OF THE PRESENTLY
FAVORABLE VIEW OF THE "ITALIAN RISK" AND SEEK A
LARGE FOREIGN LOAN FOR INVESTMENTS IN THE SOUTH.
HE CLAIMED HE HAS RECEIVED A NUMBER OF OFFERS,
INCLUDING FROM AMERICAN BANKS. HE NOTED THAT THE
PROBLEM IN THE MEZZOGIORNO WAS NOT SO MUCH THE
AVAILABILITY OF FINANCING AS THE INABILITY OF THE
GOVERNMENT MACHINERY TO SPEND MONEY. HE INDICATED
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THAT THE EUROPEAN INVESTMENT BANK HAS ALLOCATED
\$1 BILLION FOR AGRICULTURAL PROJECTS IN THE SOUTH

WHICH HAS REMAINED UNSPENT. FOR MAXIMUM DRAMATIC EFFECT, THE MINISTER WOULD LIKE TO COMBINE THE SIGNING OF SUCH A LOAN WITH A VISIT TO THE US. SUCH A TRIP WOULD BE BILLED AS A DEMONSTRATION OF FOREIGN INVESTORS' INTEREST IN ITALY AND AS A SIGN OF SUPPORT IN THE GOVERNMENT'S ECONOMIC PROGRAM.

4 RESPONDING TO THE AMBASSADOR'S QUESTION AS TO WHETHER THE MINISTER HAD THE NECESSARY POLITICAL SUPPORT FOR HIS PROGRAM, PANDOLFI SEEMED VERY OPTIMISTIC. HE SAID THE COMMUNIST PARTY FAVORED A STABILIZATION PROGRAM WHICH WOULD GET THE COUNTRY THROUGH THE NEXT TWO YEARS BECAUSE THEY DID NOT WANT EARLY ELECTIONS; THEY FEAR THAT EARLY ELECTIONS WOULD WANT A LOSS OF VOTES. THE COMMUNISTS, HOWEVER, HAVE A PROBLEM WITH THE LABOR UNIONS, WHICH ARE BECOMING INCREASINGLY UNHAPPY WITH ECONOMIC POLICIES. LAMA OF THE CGIL (COMMUNIST-DOMINATED UNION) IS REPORTEDLY PREPARED TO TAKE AN ACCOMMODATING STAND, BUT THE LEADERS OF CISL AND UIL ARE NOT. ALSO, THE SOCIALIST PARTY IS PLAYING A VERY AMBIGUOUS GAME. IT HAS NOT COME OUT IN SUPPORT OF PANDOLFI'S EFFORTS AND MAY BE THINKING, ACCORDING TO THE MINISTER, IN TERMS OF EARLY ELECTIONS IN THE HOPE OF INCREASING ITS SHARE OF THE VOTE.

5. PANDOLFI INDICATED THAT HE HAD DISCUSSED THE GENERAL OUTLINE OF HIS PROGRAM WITH WHITTOME OF THE IMF. HE CLAIMED WHITTOME HAS JUST ABOUT GIVEN HIS CONCURRENCE, SINCE THE FUND STAFF HAS COME UP WITH SIMILAR RECOMMENDATIONS ON THE PUBLIC SECTOR
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DEFICIT. A LETTER OF INTENT INCORPORATING THESE DETAILS IS NOW BEING DRAFTED. THE FUND MISSION WILL BE LEAVING ITALY NEXT WEEK TO WRITE UP ITS REPORT ON ITALY AND IS SCHEDULED TO RETURN TO ROME IN EARLY OCTOBER TO HAMMER OUT THE FINAL DETAILS FOR A NEW STAND-BY IN THE AMOUNT OF 1.0 BILLION SDRS. GARDNER

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